Alberta Non-Profit Corporations: Getting Legislation that Helps

MUTTART FOUNDATION

CONSULTATION

APRIL 23 TO 26, 2013, BANFF

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Acknowledgments

This consultation document was specifically prepared for a consultation session held in Banff in April 2013. The Muttart Foundation dedicated one of its events to the ALRI project and brought together sector representatives as well as experts from Canada, the United States, the United Kingdom and Australia.

The three day session was extremely productive, in part because of the quality and clarity of this background consultation document.

Maria Lavelle and Geneviève Tremblay-McCaig are the two counsel who jointly have carriage of this project and who authored this document. We acknowledge with gratitude their skill and expertise.

Since the document was designed for a specific event, it was not widely circulated in our usual manner. Several interested persons have asked about it and we determined to make it available on our website.

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Table of Abbreviations

	LEGISLATION
BCA	*Business Corporations Act*, RSA 2000, c B-9
CNCA	*Canada Not-for-Profit Corporations Act*, SC 2009, c 23
Companies Act	*Companies Act*, RSA 2000, c C-21
ONCA	*Not-for-Profit Corporations Act*, 2010, S.O. 2010, c. 15
Saskatchewan Act	*Non-profit Corporations Act*, 1995, SS 1995, c N-4.2
Societies Act	*Societies Act*, RSA 2000, c S-14
	LAW REFORM PUBLICATIONS
ALRI Report No. 49	Institute of Law Research and Reform, *Proposals for a New Alberta Incorporated Associations Act*, Final Report No. 49 (1987): www.law.ualberta.ca/alri/docs/fr049.pdf
BCLI Consultation	BCLI, *Consultation Paper on Proposals for a New Society Act* : http://www.bcli.org/sites/default/files/Society_Act_Consultation_Paper_0.pdf
BCLI Report	British Columbia Law Institute, BCLI Report No. 51, *Report on Proposals for a New Society Act*, July 2008
Saskatchewan Report	The Law Reform Commission of Saskatchewan, *Liability of Directors and Officers of Not-for-Profit Organizations*, July 2008, http://www.lawreformcommission.sk.ca/directorsfinal.htm
	SECONDARY SOURCES
Carter	Terrance Carter, *Directors and Officer's Liability: The Essentials and Beyond for Non-Profits*, June 8, 2007, available online at http://www.carters.ca/pub/seminar/charity/2007/tsc0608a.pdf

A. Introduction

[1] Alberta's non-profit sector makes a significant contribution to the economic and social well-being of Albertans. Given its importance, the sector needs to be supported by a governance framework that is clear and enabling. The current provincial corporate legislation does not do this well. Rather, it is characterized by gaps, inconsistencies and outdated concepts. The scope of the Alberta Law Reform Institute's project is to reform the primary non-profit corporate legislation in Alberta, the *Societies Act* and Part 9 of the *Companies Act*.[1]

[2] As of March 2012, there were 23,309 active, provincially incorporated non-profit corporations in Alberta.[2] Across the province, these organizations generate revenues of over $9.6 billion/year, employ over 175,000 people and have more than 2.5 million volunteers.[3] The non-profit sector in Alberta is extremely diverse.[4] It operates in areas ranging from sports and recreation, the arts, religion, post-secondary education to healthcare. Non-profit corporations range from those with more than $1 million in revenue and a staff of paid employees, to those with very limited revenue sources, who are entirely dependent on volunteers for program delivery. The challenge is to develop a corporate legal framework that will meet the needs of this diverse sector.

[3] Non-profit organizations may choose from one of three basic legal forms: unincorporated association, charitable trust or incorporation.[5] Incorporation, however, is generally the preferred form and is therefore the focus of this project.[6] The two

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[1] *Societies Act*, RSA 2000, c S-14 [*Societies Act*] and *Companies Act*, RSA 2000, c C-21 [*Companies Act*]. Other statutes, such as the *Religious Societies Land Act*, RSA 2000, c R-15, may form a separate part of this project.

[2] Figures provided by the Government of Alberta. As of March 2012, there were 18,846 active non-profit corporations under the *Societies Act*; 1,934 active non-profit corporations under Part 9 of the *Companies Act*; 2,889 active non-profit corporations under the *Religious Societies Land Act*; and, 738 extra-provincial non-profits registered under the *Business Corporations Act*.

[3] Imagine Canada, *The Non-profit and Voluntary Sector in Alberta*, at 10, available online at http://www.imaginecanada.ca/files/www/en/nsnvo/f_alberta_sector_report.pdf.

[4] Imagine Canada, at 10.

[5] The Broadbent Commission Report called for reform of the law for each of these three legal forms of non-profit organizations. Panel on Accountability and Governance in the Voluntary Sector, *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector: Final Report* (Ottawa: The Panel, 1999), at 74, "Broadbent Commission Report", online at: http://www.ecgi.org/codes/documents/broadbent_report_1999_en.pdf.

[6] The advantages of incorporation include: (i) limited liability; (ii) greater permanency; (iii) a defined basic structure and governing rules; (iv) external organizations, businesses and lending institutions, may be more comfortable dealing with an incorporated body; (v) some funding agencies may insist on this form before any grants or financial

continued

principal acts for incorporating a non-profit organization provincially are: the *Societies Act* and the *Companies Act*. Incorporation as a society under the *Societies Act* is the simplest and least costly way to incorporate. Some non-profit organizations incorporate under the *Companies Act*. The *Companies Act* contains more detailed and comprehensive provisions concerning the structure and operation of the organization. In ALRI Report No. 49, the Institute summarized the importance of the legislative machinery for non-profit corporations as follows:[7]

> The incorporation of a corporate entity provides an organizational structure for an activity; it defines the relationships and balances the interest of majorities, minorities and managers; it helps an organization to obtain charitable or tax-exempt status; and it protects its members against claims for things done by the corporate entity.

1. PROCESS

ISSUE 1

How can we effectively engage grassroots non-profit organizations in this reform process?

[4] This is not the first time that reform of the non-profit corporate legislation has been proposed in Alberta. In 1987, ALRI Report No. 49 recommended a new Alberta incorporated associations' act. A bill, based on these recommendations, was introduced in the Legislative Assembly and given first reading. The government of Alberta then embarked on a province-wide consultation process based on these recommendations, but ultimately the reform initiative lacked the support of grassroots non-profit organizations needed to carry it forward.

[5] As will be discussed in subsequent sections, the context for the current reform project appears to be different from that of 1987. The importance of the non-profit sector continues to grow and other Canadian jurisdictions have recently introduced legislative reforms. The question remains, however, in order to better ensure implementation of any proposed reforms, how can we effectively engage grassroots non-profit organizations in the reform process?

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assistance are provided; and (vi) in most cases in order to qualify for registered charitable status, a non-profit must first be incorporated.

[7] Institute of Law Research and Reform, *Proposals for a New Alberta Incorporated Associations Act*, Final Report No. 49 (1987) at 5: www.law.ualberta.ca/alri/docs/fr049.pdf, [ALRI Report No. 49].

2. NEED FOR REFORM

ISSUE 2

In your experience, why is the current legislation in need of reform?

[6] As we mentioned at the outset, in our view, the *Societies Act* and the *Companies Act* do not adequately support the non-profit sector and are in need of reform.

[7] A brief review of the history of the *Societies Act* and Part 9 of the *Companies Act* is helpful in better understanding the shortcomings of the current legislation. Both acts date back to the 1920s and are based on UK laws. Whereas the *Societies Act* originated with the legal framework for benevolent or charitable organizations, Part 9 of the *Companies Act* was an add-on to the companies' legislation aimed primarily at the for-profit sector.

a. *Societies Act*

[8] The current *Societies Act* has remained relatively unchanged since it was first introduced in Alberta in 1924. Like the 1924 Act, the current legislation provides for the incorporation of societies for "any benevolent, philanthropic, charitable, providence, scientific, artistic, literary, social, educational, agricultural, sporting or other useful purpose, but not for the purpose of carrying on any trade or business."[8] The Registrar continues to take an active role and can refuse an application for incorporation.[9] It leaves many of the key governance issues to be determined by the by-laws of an individual organization. While this approach provides for greater flexibility, it also leads to difficulties where societies, lacking in legal sophistication, must draft by-laws. Most of the recent cases concerning this Act involve interpretation questions or errors in the drafting of society by-laws.[10]

b. *Companies Act*

[9] Part 9 of the *Companies Act* can be traced back to Ordinance No. 3 of 1886 - the first territorial ordinance to deal with the incorporation and operation of companies. It was replaced in 1913 with the *Companies Act*. The present form of the *Companies Act*

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[8] *Societies Act*, s 3(1).

[9] *Societies Act*, s 10.

[10] See for example: *Penton v Métis Nation of Alberta Assn.*, [1995] 8 WWR 39, 171 AR 140 (QB), *Orr v Alook*, 2000 ABQB 477, [2000] AJ No 828, *Boucher v Métis Nation of Alberta Assn.*, 2008 ABQB 262, 434 AR 139, and *Kim v Kim*, 2009 ABQB 608, [2009] AJ No 1185.

closely resembles the 1929 version of the Act. The Act provides a more limited role for government supervision in that incorporation is as of right.[11] Unlike the *Societies Act*, a non-profit incorporated under the *Companies Act* can engage in business activities provided the proceeds are used to promote its objects.[12] In 1981, the Alberta government determined the *Companies Act* was obsolete and enacted the *Business Corporations Act*.[13] The *Companies Act* stopped applying to for-profit corporations on February 1, 1982.[14] The *Companies Act*, however, continues to apply to non-profit corporations.

3. REFORM IN OTHER CANADIAN JURISDICTIONS

[10] The reform trend in Canada, both provincially and federally, is to introduce new non-profit legislation that is better harmonized with the business corporation legislation in their respective jurisdictions. That is, to adopt an approach to non-profit governance that is more in line with that of for-profit corporations.

[11] Previously, Saskatchewan stood out as the only province with modern non-profit legislation. Its *Non-Profit Corporations Act* entered into force in 1995 and "has operated with few problems since then."[15] More recently, new non-profit legislation was introduced by the federal government, the government of Ontario and is being considered by the government of British Columbia.

[12] The new federal act, the *Canada Not-for-profit Corporations Act*, provides for the phased in repeal of Part II of the *Canada Corporations Act*.[16] The Act provides a modern corporate governance framework for the regulation of federally incorporated non-profit corporations.[17] It is based primarily on provisions of the *Canada Business Corporations Act* and some provincial non-profit legislation.

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[11] *Companies Act*, s 15(1).

[12] *Companies Act*, ss 200(1) and 202(1).

[13] *Business Corporations Act*, RSA 2000, c B-9 [BCA].

[14] *Business Corporations Act*, SA 1981, c B-15, s 284(5).

[15] *Non-profit Corporations Act*, 1995, SS 1995, c N-4.2 [Saskatchewan Act]. Telephone conversation with the Director of the Saskatchewan Registry Office.

[16] *Canada Not-for-Profit Corporations Act*, SC 2009, c 23 [CNCA].

[17] Wayne D. Gray, *A Practitioners Guide to the New Canada Not-for-Profit Corporations Act*, Vol. 89 Canadian Bar Review, 2010, pp 141-189, at p. 153.

[13] Ontario also passed new non-profit corporate legislation, the *Not-for-Profit Corporations Act*, in 2010.[18] Passage of the ONCA was motivated by the outdated nature of the *Corporations Act* which had been enacted in 1907 and last significantly revised in 1953, and by the desire to harmonize the Ontario law with the new federal statute. The new legislation received Royal Assent in December 2010, but has not yet entered into force pending Proclamation. There are reportedly a number of significant administrative issues to be resolved before Proclamation.[19]

[14] In 2008, the British Columbia Law Institute recommended changes to better harmonize British Columbia's *Society Act* with its *Business Corporations Act*.[20] The government of British Columbia has launched public consultations on reform of the *Society Act* and is still considering the proposal. What do you see as the strengths and weaknesses of the reform initiatives in other jurisdictions?

[15] While harmonization between sectors and between jurisdictions provides benefits, it is not an end in itself. This issues paper takes a different approach. It does not start by proposing harmonization with the business corporations' legislation in Alberta. Rather, it starts by focusing on what non-profit corporations are, what they do, and what they need to do to carry out their particular purposes in an efficient and effective manner. Having these concerns front and center will help to tailor a clear and enabling legal framework.

B. Guiding Principles and Values

ISSUE 3

What guiding principles and values do you think should be advanced through the powers and duties of a non-profit corporation?

[16] The term "for-profit" affirmatively describes the general goal of this type of corporation - that is maximizing shareholder profit. In contrast, the term "non-profit," does not offer an affirmative description of what a non-profit corporation is. It merely indicates the absence of a profit motive for this type of corporation. Non-profit

[18] *Not-for-Profit Corporations Act*, 2010, SO 2010, c 15 [ONCA].

[19] Ontario Nonprofit Network, February 8, 2013 reports that a significant amount of time will be required to work out administrative issues before proclamation and to monitor afterwards.

[20] British Columbia Law Institute, BCLI Report No. 51, *Report on Proposals for a New Society Act*, July 2008, [BCLI Report].

corporate law has developed in much the same way. Rather than a series of affirmative provisions it is typically characterized by provisions that limit or eliminate the means – or incentives – for an organization to be profitable.[21]

[17] This issues paper takes a more affirmative approach. This approach neither implies adopting nor rejecting long-standing principles of non-profit corporate law. It simply suggests that non-profit corporations' powers and duties – and any limitations or restrictions on these powers and duties– should be based on, and meaningfully advance, the desired guiding principles and values. In our view, there are at least four: strengthening the non-profit identity, enhancing sustainability, providing good governance standards and safeguards, and accommodating differences within the sector. Are there other principles and values that you feel should be advanced?

1. STRENGTHENING THE NON-PROFIT IDENTITY

[18] "Identity" refers to the set of characteristics by which a person, group or thing is recognized or known. An organization's identity – or brand – is an intangible asset that encapsulates who it is, where it is going, what it does and why that matters.[22] Internally, identity creates organizational cohesion and effectiveness by keeping a clear focus on its mission. Externally, it reflects the image that stakeholders have of an organization, and serves as a fundraising and networking tool.

[19] Of course, there are many forces involved in building an organization's identity, but there are ways to strengthen this identity through non-profit corporate legislation. For example, defining or requiring non-profit corporations to state their purpose may be part of the sector's identity. A defined purpose may lead a non-profit to use its resources more efficiently and ultimately, increase its ability to meet the needs of its members or the community. Another way to strengthen the non-profit identity may be to eliminate the forces that can distract organizations from their non-profit purpose. Prohibiting non-profit corporations from: carrying on a trade or business, issuing share capital or distributing assets to their directors or members may distinguish non-profit organizations from the for-profit sector. These prohibitions may also be important in that they may mean fewer resources will be diverted from operations. They may also

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[21] Many not-for-profit incorporation statutes impose restrictions on an organization's ability to carry on business activities, to have a share capital, to distribute assets or to use income for anything other than the furtherance of its specific purposes.

[22] Nathalie Kylander and Christopher Stone, *The Role of Brand in the Nonprofit Sector*: http://www.ssireview.org/articles/entry/the_role_of_brand_in_the_nonprofit_sector.

mean that stakeholders, who are aware of these constraints, may have greater confidence and trust in the non-profit corporations' ability to deliver services.

[20] While recognizing and strengthening the non-profit identity is important, there are trade-offs. For example, a defined purposes and restrictions on profit distribution may have an impact on sustainability as they may limit a non-profit corporation's ability to generate funds through commercial activities or its ability to attract investment. On the other hand, some donors may be attracted by these restrictions and be more likely to contribute funds.

2. ENHANCING SUSTAINABILITY

[21] One of the biggest challenges facing the non-profit sector is sustainability. There are many facets to sustainability. First, and most importantly, sustainability encompasses economic sustainability – the ability to secure continuous, diverse funding and to use those funds efficiently and effectively to further the purpose of the organization. Enabling non-profit corporations to access various sources of funding, such as, public grants, donations, member dues, but also, commercial revenue and investment capital – and to preserve these funds through tax exemptions – contributes to their financial viability and independence. Second, a stable board and the ability to attract and retain board members can enhance sustainability. Third, sustainability encompasses the ability to stay relevant, that is, the flexibility to continue to meet the changing needs of members of the public.

[22] The use of the qualifier "enhancing" before sustainability acknowledges that a legislative framework should not be overly rigid or prescriptive. Rather, it should permit a non-profit to choose from a range of options and decide for itself what best suits its particular circumstances. For example, the legislation might permit a non-profit to pursue a particular revenue-generating option, however, it would be up to the non-profit to carefully consider, what resources would be required to carry out this option and what other benefits might not be available as a result of this choice.[23]

[23] For instance, engaging in commercial activities requires a significant investment of time and money, and may unduly reduce the amount of resources available for public or member benefit work without any assurance that this enterprise is going to be profitable. Having the capacity to offer investor returns is not a guarantee that it will be able to draw enough investments to compensate for the share of gains and capital that goes back to investors, and the loss of financial benefits available exclusively to "non-distribution-constraint" organizations (e.g., tax exemption, casino licence).

[23] As with the other principles and values described in this Part, there are trade-offs to be made. Non-profit corporations that are too "profitable," especially those that engage in a commercial endeavour may be more economically sustainable, but may more easily drift away from the type of work preferred by their stakeholders. This might also increase the risk of opportunistic alteration of purpose. Good governance may also come into play as the continued trust and support of funders, donors, volunteers, members, customers or investors, whatever the case may be, requires that an organization have in place ways to track where funds come from and how they are being used to further their mission.

3. GOOD GOVERNANCE AND SAFEGUARDS

[24] In order to effectively carry out their purpose non-profit corporations also need tools to define strategies, manage resources, verify performance and readjust matters when needed. Effectiveness, efficiency, responsiveness, participation, transparency and accountability are central pillars of – and sometimes preconditions for – good governance. At the outset, the role of a legal framework is to facilitate those processes, and to delineate the obligations and rights of everyone involved. Organizations can then build on baseline good governance standards to meet their particular needs.

[25] Safeguards should only be required as a last resort to redress and remedy those situations where good governance fails. Imperative provisions should be reduced to a minimum and should serve clear and meaningful objectives. The compliance burden may be significant and may strain resources and have an adverse effect on organizations' sustainability.

[26] Once again, a balancing with the other principles and values in this Part is required. For example, robust external audit requirements may ensure good governance. However, they may divert much needed funds from operations and consequently affect the sustainability of an organization. Further, good governance standards that are appropriate for some non-profit corporations may not be appropriate for all classes of non-profit organizations.

4. RECOGNIZING DIFFERENCES WITHIN THE NON-PROFIT SECTOR

[27] A wide range of non-profit organizations may incorporate. Generally, they can be classified into four themes: charitable organizations which includes poverty assistance, educational, spiritual and other community benefit groups; social and recreational organizations which includes hobby, garden, sport and country clubs;

membership organizations which includes fraternal, professional and business associations; and advocacy organizations which includes groups that champion a particular interest or position and attempt to influence the public opinion, decision-making process, political and/or legislative action. Even within these broad classifications, there can be differences based on source of funds, revenues generated, size of the organization, etc.

[28] While non-profit corporations may share some common traits, what they do and what they need to carry out their particular purpose largely vary. Consequently, the relative importance of the principles and values identified may differ from one type of organization to another.[24] For example, strengthening the non-profit identity may be more important for a charitable organization such as the United Way than it is for advocacy organization such as the Alberta Liquor Store Owners Association. To the extent that it is possible to identify functional differences between non-profit corporations, these should be recognized and accommodated in the incorporation legislation.

C. Legislative Approach

ISSUE 4

What legislative approach should be taken with non-profit corporate legislation?

[29] A further consideration, before we identify and describe the particular issues in the non-profit corporate legislation, is that of the overall legislative approach. In this Part, we examine three broad themes: 1. What are the defining characteristics of the non-profit sector and what impact (if any) should these have on the legislation? 2. How

[24] For instance, as Nelligan and Burke note: "For the purpose of analysis, it is useful to separate corporations that currently have minimal governance structure dedicated to members from those that are highly structured in respect of members. While it is not possible to strictly delineate the two types of organizations, examples of corporations which are not structured to give members significant participation in governance include cultural institutions such as museums, art galleries, and sports or recreational organizations that sell memberships principally as a fundraising tool or as an entitlement to participate in a sport or activity, while examples of member-focused corporations would include professional or trade associations formed specifically to represent the interests of, educate and/or facilitate interaction among their members". See Margaret Nelligan and Jeremy Burke, *Governance and Member Rights Under New Not-For-Profit Legislation*: http://www.csae.com/Resources/ArticlesTools/View/ArticleId/1488/Governance-and-Member-Rights-Under-New-Not-For-Profit-Legislation. See also *Three Views on Bill C-21: Canada Not-For-Profit. Corporations Act*, The Philanthropist, Vol. 21, No. 1: www.thephilanthropist.ca/index.php/phil/article/download/18/18.

should the government fulfill its regulatory mandate in this sector? 3. How, if at all, should the diversity of the sector be accommodated through legislation?

1. DEFINING CHARACTERISTICS

[30] It has been suggested that the defining characteristics of non-profit organizations are as follows:[25]

a. They should be established for a public purpose or for the non-financial benefit of their members;

b. They should be private and independent;

c. They should be self-governing; and,

d. In general, their income should not be distributed to members, directors or officers, except as reasonable compensation for services rendered.

[31] With the defining characteristics of non-profit organizations identified, the question that follows is what impact these differences should have in determining the appropriate regulatory framework? Are the differences with the for-profit sector significant enough to warrant legislation that is separate and distinct from that of the for-profit sector? If so, in your view, how should the legislation reflect these defining characteristics? In Part D, Capacity, we will consider further what impact these key elements could have on the regulatory framework.

2. REGULATORY MANDATE

[32] The government's role in the non-profit sector has been described as having four key elements.[26] The first is a facilitative role – the government should do what it can to facilitate non-profit activity. The second is a helping role – the government should do what it can to provide funding, infrastructure and to enhance the sector's credibility. The third is a protective role – the government should introduce measures to protect the sector from fraudulent or deceptive activities. The fourth is a policing role – the government should police its own expenditures in the sector to ensure that they remain

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[25] Law Commission of New Zealand, *Reforming the Incorporated Societies Act 1908*, Issues Paper, 24 June 2011 Discussion Paper, at 5.

[26] David Stevens, *"Framing an Appropriate Corporate Law"* in Jim Phillips, Bruce Chapman and David Stevens, eds, *Between State and Market: Essays on Charities Law and Policy in Canada*, (Montreal and Kingston, McGill-Queen's University Press) 547, at 549.

properly targeted and effective. The criticism that has been levelled at past Canadian non-profit legislation is that they tended to underemphasize the government's facilitative, helping and policing role and overemphasize their protective role.[27]

[33] With respect to this current reform effort, how do we find an appropriate balance amongst these four key elements? What issues need to be included in a clear formulation of the basic legal framework for the sector? What issues could be left to non-profit corporations to work out for themselves? To what extent should non-profit legislation be imperative (written in mandatory language) versus permissive? Should it provide mandatory or default rules?[28] Should model or default bylaws be included? The challenge is to put in place legislation that strikes an appropriate balance while bearing in mind that non-profit corporations have diverse governance needs and capabilities to comply with regulatory requirements.

3. CLASSIFICATION SCHEME OR BASELINE LEGISLATION?

[34] One way legislation has tried to achieve this balance while accommodating this diversity is by having different legislative provisions apply to different categories of non-profit corporations. From a legislative perspective, this raises the practical question as to whether legislative reform in this area should incorporate a classification scheme or alternatively, set out minimum standards common to all.

[35] The principle advantage of a classification scheme is that the needs of different types of non-profit corporations could be more easily met.[29] The principle disadvantage is that it could be overly cumbersome or difficult to classify non-profit corporations.[30] The result could be that organizations are wrongly classified or do not fit well within

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[27] David Stevens, at 549.

[28] Mandatory rules not only mean that corporations must comply with those rules, but also that the legislation supersedes any inconsistent rules in the by-laws. Default rules, on the other hand, only apply when the articles or by-laws are silent; the corporation always has the option to override default rules if they do not meet its own circumstances. As L.B. Gerow J. concludes in *Grewal v Guru Nanak Sikh Gurdwara Society*, 2012 BCSC 131 at paras 35-36:

> A society cannot pass bylaws that violate the *Society Act*. Societies are creatures of statute, and cannot pass bylaws which are inconsistent with the empowering statute. If the bylaw is repugnant to the Society Act, it is ultra vires the powers of the society to adopt it: *B.P.Y.A. 1163 Holdings Ltd. v. Strata Plan VR2192*, 2008 BCSC 695 at paras. 78-84.

[29] Corporate and Insolvency Law Policy Directorate Policy Sector, Industry Canada, *Reform of the Canada Corporations Act: Discussion Issues for a New Not-for-Profit Corporations Act*, March 2002, available online: http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/optionfinal_en_ed.pdf/SFILE/optionfinal_en_ed.pdf, at 5.

[30] Industry Canada Paper, March 2002, at 5.

the defined categories. [31] In contrast, common minimum standards can accommodate a variety of different kinds of non-profit corporations, but may not be sufficiently detailed for all non-profit corporations.

[36] If a classification scheme were adopted, there are several possible bases for classification including: the source and level of funding; whether the organization is primarily intended to benefit its membership or the public; or other purposes.[32] The challenge with all of these possible bases is defining the classification so that it is neither overly broad nor overly complicated to apply. Others have suggested that a classification scheme should be based on a non-profit corporation's capacity to comply with the legislation, but this would seem somewhat circular.

[37] Regardless of the basis of classification, the areas of possible differentiation include:[33]

- Distribution of assets upon liquidation;
- Transferability and repurchase of membership;
- The rights and responsibilities of the membership;
- Member rights on fundamental changes;
- Prohibitions or restrictions on amalgamations;
- Fiduciary obligations of directors and officers; and,
- Audit requirements.

[38] What is your view? Do we need a classification scheme? If so, what should be the basis for the classification scheme?

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[31] Industry Canada Paper, March 2002, at 5. It was also noted that classification scheme might result in some confusion with the Canada Revenue Agency's rules regarding the designation of charitable status for tax purposes.

[32] The Ontario Law Reform Commission recommended a rather complicated classification scheme which divided non-profit corporations into the following five categories: religious, political, charities, mutual benefit and general. "The Nonprofit Corporation: Current Law and Proposals for Reform," in Report on the Law of Charities, vol. 2 (Toronto: The Commission, 1996) 451–506, at 460, 465–466.

[33] Ontario Ministry of Services – Policy and Consumer Protection Services Division, *Modernization of the Legal Framework Governing Ontario Not-for-Profit Corporations*, Consultation Paper, May 7, 2007, at 19.

D. Capacity

[39] Broadly defined, "corporate capacity" refers to what a corporation is empowered to do. There are different ways to circumscribe corporate capacity: restrict the purposes of incorporation, restrict the activities of the corporation, and restrict the exercise of powers. Such restrictions should be justified, meaningful and enforceable as they define management duties and the membership rights. But all these pieces also need to work together – whether by complementing or supplementing each other. Therefore, an understanding of the broad picture is essential for setting out a coherent and enabling legal framework for non-profit corporations.

1. DOCTRINE OF ULTRA VIRES

ISSUE 5

Should the doctrine of ultra vires be abolished? If so, how can it be effectively done?

[40] Unlike a natural person, a corporation does not have the capacity to do whatever it wants. Corporate capacity is, instead, limited by what the governing statute, the constitutive documents, and particularly the objects clause, authorize the corporation to do. Anything else would be ultra vires – that is beyond the capacity of the corporation and void or voidable at common law – potentially putting the directors who sanctioned such transactions in breach of their duties.

[41] The doctrine was a blunt instrument, and at best could only nullify contracts which exceeded the capacity of a corporation. Inequities were also exacerbated by the fact that the application of the doctrine did not depend on whether the third-party who had contracted with the corporation had actual knowledge of the corporation's lack of capacity.[34]

[42] By the time new for-profit incorporation legislation was being considered in the 1970s, it was obvious that the doctrine of ultra vires should be abandoned, and that modern devices should be developed to protect creditors and shareholders from improper or profligate activity on behalf of management. To this end, the general

[34] According to the doctrine of constructive notice anyone dealing with a registered corporation was deemed to have had notice of the contents of public constitutive documents which are available for inspection. The doctrine of indoor management limited the effect of the doctrine of constructive notice by providing that outsiders were however entitled to presume that internal requirements prescribed those documents have been properly observed.

approach was to confer on corporations all the powers, rights and privileges of a natural person. From then on business corporations had the capacity to do anything they wished, unless otherwise provided in their governing statute or documents. Most recently, there have been calls to abolish the doctrine for non-profit corporations as well.

[43] Even without the doctrine of ultra vires, non-profit corporations still have to comply with the requirements, formalities and procedures set out in their statute and other governing documents, such as articles of incorporation, by-laws or unanimous member agreements. This creates both external and internal "checkpoints" which help define the rights, obligations and roles of the management and constituency.[35]

[44] Those checkpoints generally take the form of restrictions on incorporation purposes, commercial activities, asset distribution, and the exercise of powers, rights and privileges. They can be enforced by public authorities, such as the corporate registry or the courts, but also by the corporation's constituents, such as the members or the funders/donors, depending on the circumstances. Appropriately designed they enhance the ability of the different stakeholders to ensure that: the mission of the corporation is circumscribed and adhered to; the operations and resources are directed to the mission; and no unauthorized transactions are carried out in the first place, rather than invalidated after the fact.[36]

2. PURPOSES

[45] The purpose of an organization is the reason for which it is incorporated; it is the outcome that is intended and the aim toward which the corporation strives. The purpose defines goals, directs actions and efforts, and establishes targets against which results can be measured and reported. For instance, a corporation's purpose may be to reduce the incidence of poverty amongst Albertans with physical or cognitive disabilities. Of course, there are many things that can be done to effectuate that purpose, such as providing housing, transportation, education, training or employment. However, the purpose itself remains poverty reduction for the disabled in Alberta, regardless of how the corporation chooses to achieve it.

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[35] There are powerful incentives – for example, gaming license, fundraising registration, tax exemptions – to comply with requirements found in other statutes which also act as checkpoints.

[36] However, protecting the interests of the stakeholders also means not overburdening non-profit corporations with requirements. For more details, see Part F, *Member Rights and Remedies*.

[46] Restricted purposes have been a hallmark of non-profit corporate law. A restriction can be expressly imposed in the incorporation statute or flow from the statement of purpose of the corporation. Such devices help to strengthen the non-profit identity of a corporation, but also impose the responsibility to stay within the boundaries that this sets. Therefore, assuming that the doctrine of ultra vires is abolished, restricted purposes may still be useful as a general checkpoint.

ISSUE 6

In your view, should non-profit corporate legislation restrict the incorporation purpose? Require a statement of purpose?

a. Statutory restriction on purpose of incorporation

[47] Many statutes restrict incorporation to purposes that are considered non-profit in nature. However, as non-profit purposes encompass basically everything but profit, those acts merely set out blanket categories of permitted purposes, such as philanthropic, charitable, religious, scientific, cultural, recreational, social, educational, political, professional, agricultural, or any other useful purpose.[37]

[48] The problem is that a statutory restriction on purpose says nothing about the reason for incorporation except that it falls within broadly enumerated purposes. As a result it has been common to add a further restriction related to "carrying on a business". However, that restriction has sometimes been construed so as to limit non-profit corporations' ability to engage in commercial or revenue-generating activities as a way to achieve non-profit purposes.

[49] Lately, restricted purposes appear to have lost favour in non-profit corporate legislation. For example, under the CNCA, corporations have unrestricted purposes.[38] This can be interpreted as indicating that non-profit corporations are now free to do business in any area they chose, and can diversify away from their original business, which may not be particularly desirable for non-profits. However, the question is whether maintaining restricted purposes effectively ensures that corporations are constituted for non-profit purposes and strengthens their identity, or unduly constrains non-profit corporations without offering any real benefit.

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[37] See *Societies Act*, s 3(1): "Five or more persons may become incorporated under this Act for any benevolent, philanthropic, charitable, provident, scientific, artistic, literary, social, educational, agricultural, sporting or other useful purpose, but not for the purpose of carrying on a trade or business". See also *Companies Act*, s 200(1).

[38] CNCA, ss 6-7.

b. Statement of purpose

[50] Whether or not it restricts the purpose for incorporation, the legislation can require that non-profit corporations include a statement of purpose in their constitutive documentation.[39] Such a statement of purpose entails describing the aim or main intent of the corporation with more precision.[40] The rationale is that a stated purpose furthers internal cohesion because it forces the organization to think about what it intends to do and why it is relevant. A cohesive organization is able to make more efficient and focused use of resources which contributes to a heightened level of trust; this, in turn, increases its ability to attract and retain directors, members, funders, donors and volunteers. In addition, stated purpose provides a benchmark against which to measure results.

[51] As long as the legal function of this device is clear, a stated purpose may also be a way to give content to corporate rights and obligations.[41] Some people suggest that the statement of purpose acts as a mechanism for internal control and helps in preventing misuse of resources and in controlling mission drift. However, others are of the view that non-profit corporations do not need to describe the reason for incorporation but should be free to include a statement of purpose in their articles if they so choose.[42] While this position has the advantage of offering a great deal of flexibility, it leaves no way to make sure that non-profit corporations stay true to their purpose, whatever it might be, and consult their constituents should there be any departure from this purpose.[43]

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[39] In the UK, companies no longer have to register objects under the *Companies Act 2006*, and even if they do the doctrine of *ultra vires* has been abolished against third parties. The stated purpose is only relevant in a complaint against directors or officers for breach of duty when they have failed to act in accordance with that purpose. See *Companies Act 2006*, ss 31, 39-42 and 171.

[40] To be registered as charity with the CRA, non-profit organizations have to describe their charitable purpose. This means that corporations seeking charitable status must have a statement of purpose in their constitutive documents, whether or not the corporate statute requires doing so.

[41] The purpose of this statement is to delineate the duties of the directors – such as the duty of obedience or fidelity – and rights of the members – such as the right to vote on fundamental changes. It should be clear that this is meant to provide a mechanism for internal control, and not a premise for the application of the doctrine of ultra vires. See, for instance, BCA, ss 16(1), 17, 19, 122(2), 173(1) and 248.

[42] See *Three Views on Bill C-21: Canada Not-For-Profit. Corporations Act*, The Philanthropist, Vol. 21, No. 1, at p 80: www.thephilanthropist.ca/index.php/phil/article/download/18/18.

[43] As the authors of ALRI Report No. 49, at 33, note:

> The *Business Corporations Act* does not require that the purposes of a corporation be stated. We think, however, that for this purpose there is a material difference between a business corporation and an incorporated association. A business corporation is formed for the generalized purpose of economic gain for its members and economic efficiency is best served by leaving it free to do whatever is profitable. A non-profit association, however, is usually

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c. Incorporation process

ISSUE 7

Should incorporation be as of right? Or subject to the discretion of corporate authorities?

[52] Another checkpoint can be found in the incorporation process itself. For example, under the *Societies Act* the purposes of incorporation must be reviewed and approved by Corporate Registry.[44] The Registrar has the power to direct applicants to strike out or modify their stated purposes; incorporation can be refused for any reason the Registrar considers sufficient.[45] Subsequent changes to purposes must also be reviewed and approved by Corporate Registry to become effective. Beyond that, however, there is no monitoring power to ensure that the societies are operated for the purposes for which they are incorporated. For instance, the corporate annual return does not include any affirmation of whether the corporation is adhering to its purpose.

[53] The review and approval process offers a mechanism for some external control and may act as a shortcut in the decision making of potential funders, donors, volunteers, members, partners, lenders, investors or clients.[46] This process has nevertheless a number of drawbacks: first and foremost, it initially requires a significant expenditure of time and resources from both applicants and corporate authorities, and can subsequently deter non-profit corporations from renewing their purposes to keep them current and relevant. In recent years, there have been calls to replace the discretionary system with the simpler and faster incorporation as of right. If the review and approval process no longer serves its objectives a better option may be to focus on checkpoints that are likely more efficient overall. What do you think?

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formed for a specific purpose to which its members and, in the case of a charity, those who have donated money and effort to it, should be able to confine its activities.

[44] This control mechanism presupposes that the corporate statute requires applicants to have stated purpose(s).

[45] See *Societies Act*, ss 10-11.

[46] Incorporation under a statute which sets out appropriate guarantees may ease and speed up a qualification process for benefits available to non-profit organizations - e.g. charitable status for tax exemption.

3. ACTIVITIES

ISSUE 8

In your opinion, should non-profit corporations be allowed to engage in commercial activities? If so, should non-profit corporations be required to devote any profit generally to their purpose, and no other?

[54] It is important to distinguish between a corporation's purpose and activities. The activities describe the way the corporation will accomplish its purpose. Thus even restricted purpose does not necessarily limit the activities the corporation can carry out to further that purpose. In our example, to reduce the incidence of poverty amongst Albertans with physical or cognitive disabilities, the non-profit organization may choose to operate thrift stores both to provide training and employment for disabled people, and to generate funds to help achieve its mission.

[55] Non-profit legislation generally provides that organizations cannot be incorporated primarily to pursue a business purpose. This is often construed as a restriction on a non-profit corporation's ability to carry out regular or continuous commercial activities. For instance, section 3(1) of the *Societies Act* states that: "Five or more persons may become incorporated under this Act for any benevolent, philanthropic, charitable [...] or other useful purpose, but not for the purpose of carrying on a trade or business". This provision is interpreted as meaning that organizations incorporated under the Act cannot engage in any business operations of significant or permanent nature.[47]

[56] Although the aim of this type of restriction is to ensure that running a business does not become a purpose in its own right, it also limits what a non-profit organization can do to deliver expected benefits to the target clientele and/or to diversify sources of funding.[48] Maybe this is simply the result of confusing the purpose of a corporation with the activities it undertakes to achieve that purpose. But the question is whether it is

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[47] See, for example, the Muttart Foundation, *Drafting and Revising Bylaws for Not-for-Profit Organizations in Alberta* at p 11 and 61: http://www.muttart.org/sites/default/files/downloads/publications/drafting_revising.pdf.

[48] This is especially questionable considering that other statutes which give non-profit organizations access to competitive advantage do not impose blanket restrictions on business operations. Under the ITA, for instance, organizations which carry out community development activities and/or related business activities may qualify for charitable registration as long as all their activities further charitable purposes. The ITA also contains certain restrictions on political activities for registered charities. See CRA CPS-022, Political *Activities*: http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-022-eng.html

possible to leave corporations free to decide how to best accomplish what they set out to accomplish without blurring the lines between for-profits and non-profits.

a. Commercial activities

[57] A business generally involves commercially producing, distributing, selling or otherwise providing goods and services in the marketplace. Whether a particular activity is considered a business depends on the facts and circumstances of each case.[49] There are different reasons why a non-profit organization may choose to actively engage in a business operation. A commercial activity in and of itself is sometimes the means chosen to achieve a non-profit purpose.[50] Such undertaking focuses on improving economic opportunities and social conditions of an identified group or community, and is often done on a cost-recovery basis. In most cases, however, a commercial activity is carried out to generate funds for the organization.[51] Either way, this may not be a concern if the commercial activity remains subordinated to a non-profit purpose in the context of the organization's operation as a whole, and does not unduly divert resources and attention from that purpose.

b. Use of profit

[58] A commercial activity usually has the potential to yield profit. The question is what the corporation does with it? A restriction on the use of profit may be one option to ensure that any surplus derived from a commercial activity is applied to the corporation's purpose. For instance, the *Companies Act* provides that it must be "the intention of the association to apply the profits, if any, or any other income of the association in promoting its objects".[52] This type of restriction does not in and of itself

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[49] For instance, holding fundraising event of a particular type, such as bake sale, concert, dance or golf tournament, could be considered a business activity, but not amount to carrying on a business if it is not continuous or regular commercial operation.

[50] This includes, for example, activities seeking to offer employment or training to disadvantaged groups or to improve socio-economic conditions in an area of social and economic deprivation. Organizations that carry out community economic development activities may be eligible for charitable registration under the *ITA* if all their activities further charitable purposes.

[51] Registered charities under the ITA can carry on a related business which furthers their charitable purposes. The CRA defines a related business as a commercial activity that is either linked and subordinated to the charity's purpose or substantially run by volunteers. Some non-profit organizations do not have charitable – or at least exclusively charitable – purposes and cannot register for charitable status. Nonetheless, those organizations that pursue a purpose other than profit may still qualify for tax exemption.

[52] *Companies Act*, ss 200(1) and 202(1). Similar restrictions on the use of proceeds are found in other statutes. For instance, under the *Gaming and Liquor Act*, RSA 2000, c G-1, s91 and *Gaming and Liquor Regulation*, Alta Reg 143/1996, an organization must state in its application how it will use gaming proceeds prior to receiving its licence to ensure that those proceeds are only used for purposes essential to the delivery of the organization's approved program.

guarantee that a revenue-generating activity is ancillary to any non-profit purpose.[53] It implies however that when an organization is incorporated for a specific non-profit purpose, it is must devote its resources to that purpose, and no other.[54] Financial transparency and accountability can go hand in hand with a restriction on the use of profit to create yet another checkpoint.

4. ASSET DISTRIBUTION

ISSUE 9

Should non-profit corporations be restricted from distributing income or property to stakeholders during its existence? Upon dissolution?

[59] A for-profit corporation is expected to strive to augment the wealth of its shareholders by increasing dividend payments and/or share prices. The shareholders are the corporation's owners and have different rights depending on their class of share. These rights include: the right to elect and dismiss directors, the right to vote on major issues and changes, the right to dividends if declared, the right to a share of equity, the right to transfer ownership, and the right to what assets remain upon liquidation and dissolution.[55] However, some of the above rights do not sit well with the non-profit corporate model, especially those related to the distribution of gains and capital.

a. Payments to pecuniary stakeholders

[60] Can individuals have a money stake in a non-profit corporation? In our example, would it be an issue if the non-profit corporation offered to its disabled employees the opportunity to become shareholders of the thrift stores they work for? There is a long-standing principle that a non-profit corporation cannot be incorporated for the purpose of making profit, nor can it be structured to maximize shareholder value. So most non-profit corporate statutes contain restrictions on share capital and payment of dividends. For instance, the *Societies Act* provides that: "No society shall have a capital divided into

[53] Focussing solely on the use of profit can indeed be misleading. Earning revenues to fund non-profit activities is not in itself a non-profit purpose. For instance, recent CRA interpretations seem to indicate that organizations may be considered to have a profit purpose if they undertake activities with the intention to realize a gain, regardless of what the intentional profit is used for. However, many commentators believe this approach is wrong because it does not reflect the reality of how non-profit organizations are operated and confuses the purpose of an activity with the purpose of the organization.

[54] Therefore, a clear statement of purpose may be here again necessary to give actual content to this requirement.

[55] The issue of voting rights is treated in more detail in the Section F on *Member Rights and Remedies*.

shares or declare any dividend [...]".[56] Sometimes, however, paying investment returns is not the purpose of a corporation but a way to attract private capital for a non-profit purpose; the question is whether this may be allowable.[57] For example, it may be acceptable for a non-profit corporation to pay a small dividend to investors, as long as the rate of interest is fixed and not related to the corporation's profit.

[61] There are levels of ownership which accompany the main classes of securities that a corporation can issue: common shares, preferred shares and bonds; some of those do not include any right to vote and/or right to a share of equity. There are also various forms of financial arrangements which can be used to raise capital, such as low- or no-interest loans.[58] Enabling non-profit corporations to access diverse and steady sources of funding contributes to their sustainability. It may, therefore, be worth breaking down the issue to better assess the necessity of having blanket restrictions on share capital and asset distribution.[59] In addition, many devices, such as a restricted purpose, a cap on returns and an asset lock may help to ensure that funds are not diverted but, rather, reinvested in non-profit corporations.

b. Payments to non-pecuniary stakeholders

[62] The non-distribution constraint is not limited to individuals who have ownership rights in the corporation; it also extends to those who exercise control over it. There is therefore another principle that income and property cannot flow from a non-profit corporation to its members, directors or officers.[60] Such payments are generally

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[56] See *Societies Act*, s 4(1). See also CNCA, s 4.

[57] See British Columbia's Bill 23, *Business Corporations Act*, Part 2.2 – *Community Contribution Companies*, 2012 and Nova Scotia's Bill 153, *Community Interest Companies Act*, 2012. See also Richard Bridge and Stacey Corriveau, *Legislative Innovations and Social Enterprise: Structural Lessons for Canada*, February 2009: http://www.centreforsocialenterprise.com/f/Legislative_Innovations_and_Social_Enterprise_Structural_Lessons_for_Canada_Feb_2009.pdf.

[58] For example, section 234 of the CNCA clearly provides that: "If a person has transferred property to a corporation subject to the condition that it be returned on the dissolution of the corporation, the liquidator shall transfer that property to that person."

[59] For instance, if equity capital is the real problem, it may not be necessary to exclude other forms of private financial investment or arrangement, such as bonds and low- or no-interest loans. As Linda Sugin points out:

> The non-distribution constraint that characterizes nonprofit organizations is the consequence of the adherence to mission, not vice versa. The constraint guarantees that the organization will be operated to achieve its mission, and never for the benefit of shareholders or other private interests. As soon as profits can be paid out to individuals, the role of directors becomes unclear and conflicted. No board can simultaneously treat its charitable mission and its shareholders' private pecuniary interests as paramount.

See Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 Fordham L. Rev. 893 (2007) at p 918: http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4315&context=flr.

[60] See *Societies Act*, s 4(1) and *Companies Act*, ss 200(1) and 202(1). See also CNCA, s 34(1).

restricted during the existence of the corporation. The restriction is designed to ensure that those who oversee the non-profit corporation have no pecuniary incentive to advance their own interests rather than that of the corporation's. For instance, the *Societies Act* provides that: "No society shall [...] distribute its property among its members during the existence of the society." This is yet another way to make sure that resources and attention are devoted to the non-profit purpose. However, the question is whether there should be exceptions to this restriction based on the type of non-profit corporation, and other practical considerations.[61] For example, it may be acceptable for a non-profit corporation to pay its staff and directors compensation, as long as it is not to support unreasonable salaries or spending. Although most statutes are silent on the question, the distribution of assets to members upon dissolution may also be an issue, especially for those organizations that hope to qualify for charitable registration under the *ITA*.[62]

5. POWERS

[63] Corporate powers are legal tools used by a corporation to carry out the day-to-day activities it chooses to undertake to achieve its purpose. In our example, to operate the thrift stores, the non-profit corporation needs to be able to contract with suppliers, to rent business space, to buy equipment, to take loans, etc. The current legislative trend is to provide non-profit corporations with all the powers, rights and privileges of a natural person – and those powers, rights and privileges are unrestricted – unless otherwise provided by the governing statute or documents.[63]

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[61] The answer to that question may depend on whether the corporation is a member benefit or public benefit organization, or on whether the organization wishes to receive favourable tax treatment and/or other incentives. To be truly enabling the legal framework needs to provide the guidance which will allow organizations to include the non-distribution clause(s) in their governing documents in accordance with their needs and circumstances. Moreover, it may be necessary to make clear that this restriction does not prevent the payment of reasonable salaries or other forms of compensation for goods or services provided by members, directors or officers for the normal operation of the corporation, or private benefit that is incidental to achieving the non-profit purpose of the corporation (i.e. members who are eligible beneficiaries of a program).

[62] See also Part H, *Fundamental Changes*.

[63] As previously mentioned, it was not always clear whether there needed to be any reference to mere powers, as distinct from objects or purposes, for a corporation to have them.

a. General exercise

ISSUE 10

Should non-profit corporations be expressly required to use their powers, rights and privileges in furtherance of their purpose?

[64] Directors and officers can generally use the powers granted to the corporation as they think fit. In some cases, however, non-profit corporate legislation provides that those powers must be exercised only to further the corporation's purpose. For instance, the *Societies Act* states that societies can borrow money and give guarantees for the purpose of carrying out their objects.[64] But there are also examples in non-profit legislation where corporations have all the powers, rights and privileges of a natural person, and directors and officers are expressly required to use those powers in accordance with the purposes set out in the corporations' articles.[65] Whether such requirements effectively promote adherence to purpose and good governance, or simply reduce the ability of directors or officers to meet changing needs and circumstances is debatable. What is your view?

b. Specific formalities

ISSUE 11

Should non-profit corporations be required to comply with any mandatory formalities when exercising their powers, rights and privileges? Should default rules apply when governing documents are silent?

[65] In addition, the exercise of corporate powers can be subject to specific formalities. For instance, under the *Societies Act* directors must not only use their power to borrow money and give guarantees in furtherance of the corporation's purpose, but also obtain the approval of members by special resolution.[66] The CNCA no longer

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[64] *Societies Act*, ss 18-19. In addition, section 17 provides that provides that any funds (presumably including any investment) must be used to further the society's objects. It should also be noted that recent CRA interpretations suggest that investing to produce property or investment income is considered to be undertaken to earn a profit, unless the income-generating assets will themselves be used to further a not-for-profit purpose of the organization in a reasonable time-frame. However, a one-time capital gain from the disposition of property does not generally affect an organization's tax-exempt status.

[65] For example, Nova Scotia's *Community Interest Companies Act*, s 13(1)(c) provides that community interest companies – which have all the powers, rights and privileges of a natural person – cannot transfer any of their assets other than in furtherance of their community purpose.

[66] The *Companies Act* does not require a special resolution. None of the Saskatchewan, Ontario or Federal non-profit legislation requires that a special resolution be passed before a debenture is issued. The rationale is that this is a matter that would fall under a director's general grant of authority to supervise the management of the affairs of the

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requires member authorization to borrow or grant security; however, corporations can choose to restrict those powers in the by-laws or articles.[67] There are many examples of corporate powers that carry formalities: corporate seal, execution of documents, annual financial statements, nomination of directors, notice of meeting to members, etc.

E. Directors and Officers

[66] Where does the appropriate balance lie between holding directors and officers accountable and providing appropriate protection from liability?[68] As the non-profit sector takes on an increasingly important role in Alberta, there are calls for greater public accountability. Many non-profit board members, however, may be unaware of or unclear about their duties and liabilities. Committed volunteers, motivated by a desire to contribute to their community or member organizations, board members risk personal liability if they do not adequately fulfill their duties and responsibilities.[69]

[67] While legislation is not the only to tool available, it can assist in striking the appropriate balance.[70] This Part focuses on two key issues: 1. How should non-profit corporate legislation help to ensure the duties and liabilities of directors and officers are delineated more clearly? And, 2. What protection from personal liability should be provided to them?

1. DUTIES AND LIABILITIES OF DIRECTORS AND OFFICERS

ISSUE 12

Should the legal duties of directors and officers be codified in the non-profit corporate legislation? If so, which ones?

[68] The basic responsibility of directors, whether in the for-profit or non-profit sector, is to manage and direct the organization. Directors and officers of a non-profit corporation, like other members of a corporation, generally enjoy limited liability.

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corporation. See also BCLI, *Consultation Paper on Proposals for a New Society Act*: http://www.bcli.org/sites/default/files/Society_Act_Consultation_Paper_0.pdf, at 95 [BCLI Consultation]

[67] CNCA, s 28.

[68] The Law Reform Commission of Saskatchewan, *Liability of Directors and Officers of Not-for-Profit Organizations*, July 2008, http://www.lawreformcommission.sk.ca/directorsfinal.htm, at 2 [Saskatchewan Report].

[69] Saskatchewan Report, at 2.

[70] Other tools include education, policies and codes of conduct.

However, the "corporate veil" that protects them from personal liability may on occasion be pierced. Accordingly, they risk being found personally liable both at common law and by statute.[71] At common law, they can be found personally liable for breaching their fiduciary duties. They can also be found personally liable in tort or in contract.[72] Specific statutory provisions may also provide that directors and officers can be held personally liable.[73]

[69] Currently, the non-profit corporate legislation in Alberta provides little guidance on the duties or liabilities of directors or officers. Accordingly, one must look to the common law, and an organization's by-laws or other constitutive documents to determine what they are. This approach, however, has at least a couple of shortcomings. First, it may be difficult to ascertain what the duties and liabilities are at common law and the case law may introduce complexities that are not appropriate to all non-profit corporations. Second, the contents of by-laws or constitutive documents may differ from organization to organization and may not reflect baseline standards of conduct that should be common to all directors, regardless of the organization.

[70] Other Canadian jurisdictions have responded to similar shortcomings in their non-profit corporate legislation by importing the standards for directors and officers found in the for-profit sector. This approach has some advantages in that the non-profit sector can benefit from the wealth of existing jurisprudence around the interpretation and application of these standards. This approach has disadvantages, however, where the standards developed in the for-profit sector are not entirely appropriate for the non-profit sector.[74]

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[71] Terrance Carter, *Directors and Officer's Liability: The Essentials and Beyond for Non-Profits*, June 8, 2007, available online at http://www.carters.ca/pub/seminar/charity/2007/tsc0608a.pdf [Carter].

[72] A full elaboration of these areas is beyond the scope of this document. For reference, please refer to Carter.

[73] Examples of the specific statutes providing for the personal liability of directors and officers include: failing to contribute to an employee pension plan and other related labour statues e.g. *Employment Pension Plans Act*, RSA 2000, c E-8, *Workers Compensation Act*, RSA 2000, c W-15, *Health Insurance Premiums Act*, RSA 2000, c H-6, *Occupational Health and Safety Act*, RSA 2000, c o-2. They may also be personally liable where the corporation has not complied with environmental protection and enhancement procedures e.g. *Environmental Protection and Enhancement Act*, RSA 2000, c. E-12. In addition, they may be found personally liable under human rights or trust legislation e.g. *Alberta Human Rights Act*, RSA 2000, c A-25.5.

[74] Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 Fordham L. Rev. 893 (2007) at 905.

a. Fiduciary duties and the duty of care

[71] Directors of corporations are fiduciaries of the corporation they serve.[75] Simply put, the basic fiduciary duty owed by a director is to act honestly, in good faith, and in the best interest of the corporation.[76] As such, officers and directors are obliged not to put themselves in positions of conflict with their duty to the corporation. In addition, directors and officers are expected to perform their duties in accordance with a certain standard, generally referred to as the "duty of care."

[72] There are no provisions in either the *Societies Act* or the *Companies Act* that set out a director's fiduciary relationship to the corporation. The absence of statutory provisions clearly articulating the duty owed and the standard of care required is reportedly a disincentive for persons to serve as directors and officers of non-profit corporations.[77] What do you think?

[73] Most for-profit legislation and more recent non-profit corporate legislation include a provision codifying a director's fiduciary duty and the duty of care in the legislation. For example, s 109 of the Saskatchewan Act provides:

> 109(1) Every director and officer of a corporation, in exercising his or her powers and discharging his or her duties, shall:
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

[74] Legislative provisions, like the one above, typically set out an objective standard by which to judge directors and officers. Directors and officers must exercise the care, diligence and skill that a "reasonably prudent person" would exercise in comparable circumstances. In contrast, currently, directors of a non-profit corporation in Alberta are held to a common-law subjective standard of care that varies depending on a director's knowledge and expertise. The subjective standard asks – what level of skill and care can

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[75] *BCE Inc v 1976 Debentureholders*, 2008 SCC 69, para 37. See also *Galambos v Perez*, 2009 SCC 48, [2009] 3 SCR 247, directors are described as "fiduciaries" because they have the discretionary power to affect another party (the corporation's) legal or practical interest.

[76] Fiduciary duties have been variously described. The Saskatchewan Report describes them as diligence, prudence and loyalty. Carter (at 5-6) describes them as the duties to act honestly, duty of loyalty, duty of diligence, duty to exercise power, duty of obedience, duty to avoid conflict of interest, duty of prudence, and duty to continue.

[77] Saskatchewan Report, at 18.

reasonably be expected from a person with the director's knowledge and experience?[78] This means, for example, that a director with financial training might be held to a higher standard than another director with no such background. This subjective standard is also reportedly a barrier to the recruiting, training and retention of qualified individuals.[79] What has been your experience?

[75] Generally, statutory provisions, like the one above, extend the fiduciary duty not only to directors, but to officers as well. The Supreme Court of Canada in *Canadian Aero* held that officers who act as "top management" and "not mere employees" are subject to the same fiduciary duties as directors.[80] While it may not always be the case that officers in non-profit corporations act as "top management", should the fiduciary duty nevertheless be extended by statute to all officers?

b. Other duties

[76] In your opinion, are there other duties of directors and officers that should be codified in legislation? Are there other areas where it would be helpful to directors and officers to have a clear articulation of their duties? Are these duties best elaborated in legislation or elsewhere, for example, in a code of conduct or model by-laws?

[77] Possible areas of codification include:

a. The Duty to Comply with the Law – Some statutes expressly provide that every director and officer of a corporation is required to comply with the non-profit corporate statute, the regulations and the articles and the by-laws of the corporation.[81] This codifies the general duty of a director to act within the law.

b. Conflicts of Interest – While a duty to avoid conflicts of interest falls within the basic fiduciary duty, this does not answer the practical question of what to do when a conflict of interest arises. Under the common law, courts take a very strict approach requiring that corporate directors avoid an actual conflict

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[78] Carter, at 4.

[79] Industry Canada, *Reform of the Canada Corporations Act – Discussion Issues for a New Not-for-Profit Corporations Act*, at 15.

[80] *Can. Aero v O'Malley* [1974] SCR 592, para 22.

[81] See for example, s 148(2) of the CNCA:

> Every director and officer of a corporation shall comply with
>
> (a) this Act and the regulations; and
>
> (b) the articles, the by-laws and any unanimous member agreement.

of interest or the appearance of a conflict of interest in their dealings with the corporation. As an alternative approach, some statutes acknowledge that conflicts of interest will arise from time to time and include procedural provisions to deal with these situations. These provisions typically set out procedures to follow regarding disclosure and other conditions that can protect the validity of a contract.[82]

2. PROTECTION FROM PERSONAL LIABILITY FOR DIRECTORS AND OFFICERS

ISSUE 13

What protection from personal liability would you like to see made available to directors and officers?

[78] An accountable non-profit sector is important. Non-profit corporations are increasingly expected to account for the stewardship of monies received and the safety or quality of services provided. The public can also seek reasonable compensation for wrongs committed by non-profit corporations.

[79] The threat of personal liability of directors and officers is one possible form of inducement for board members to fulfill their duties. That being said, however, personal liability is a fairly blunt instrument, especially when one considers the typical profile of a board member in the non-profit sector. As the Law Reform Commission of Saskatchewan observed:

> The liability of board members of not-for-profit corporations is almost identical to the liability of directors and officers of business corporations. But unlike a director or officer of a business corporation, a board member in the not-for-profit sector is usually an unpaid volunteer, who can devote only limited time and attention to his or her duties. While board members bring a variety of experience to the organization, many lack business or managerial experience. It is often difficult for volunteer board members to identify the risks that might lead to personal liability. [83]

[80] Accordingly, both in the for-profit and in the non-profit sector, legislative mechanisms have been introduced to help guard against potential liability. The range of

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[82] For example, s 107 of the Saskatchewan Act requires a director or officer of a non-profit corporation to disclose in writing (or to have entered into the minutes) a contract or proposed contract in which he or she has a material interest. No director with a conflict of interest may vote on a resolution to approve the contract unless certain conditions are met.

[83] Saskatchewan Report, at 7.

possible mechanisms is discussed below. The key issue is how to find the right balance such that a bad actor is not protected, but a board member, who acts conscientiously, is provided with some measure of security.

a. Due diligence defence

[81] 'Due diligence' means that a director or officer has met the standard of the duty of care we discussed in the preceding section. Or, in other words, has exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. A due diligence defence means that it is up to the director or officer to prove that he or she met the standard in carrying out the duties of director or officer.

[82] Neither the *Societies Act* nor the *Companies Act* includes a due diligence defence. More recent Canadian non-profit corporate legislation, however, has included such a provision in order to clarify that this defence (which is part of the common law) is available to directors and officers of non-profit corporations. The statutory formulation usually also makes it clear that a director or officer is excused from liability where they have reasonably relied on professionals.

[83] For example, s 149(1) of the CNCA provides:

> **149.** (1) A director is not liable under section 145 or 146, and has complied with his or her duties under subsection 148(2) and (3), if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on
>
> (a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the public accountant of the corporation fairly to reflect the financial condition of the corporation; or
>
> (b) a report of a person whose profession lends credibility to a statement made by that person.

b. Indemnification and liability insurance

[84] Given the potential for liability, the availability of indemnification and insurance for directors and officers of non-profit corporations is an important consideration. Currently, neither the *Societies Act* nor the *Companies Act* addresses these matters.

[85] The trend in modern non-profit corporate legislation is to include provisions that permit a corporation to indemnify and/or purchase insurance for their directors and

officers provided certain conditions are met. For example, the Saskatchewan Act permits a non-profit corporation to indemnify their directors and officers for costs, charges and expenses incurred in a court action resulting from any act made or permitted by them in the execution of their duties provided they acted honestly and in good faith with a view to the best interests of the corporation. An additional condition is usually added in the case of a criminal or administrative action or proceeding enforced by a monetary penalty, such that the director or officer must have had reasonable grounds to believe their conduct was lawful.[84]

[86] The inclusion of an indemnity provision raises a number of considerations: Should it be available to both directors and officers? Should it be at the discretion of the corporation or mandatory? What conditions must be met before it is available? What costs would it cover? The main practical limitation of an indemnity provision is that any lawsuit resulting from a director's alleged misconduct is likely to be brought against both the non-profit corporation and the director. Where the lawsuit is successful, a non-profit corporation may lack the financial resources to honour its indemnification provision.

[87] The availability of insurance for direct liability of directors and officers may complement an indemnification provision and help to supplement the financial resources available to a non-profit corporation. For example, the Saskatchewan Act provides that:[85]

> (5) A corporation may purchase and maintain insurance for the benefit of an individual mentioned in subsection (1) against any liability incurred by the individual in the individual's capacity:
>
> (a) as a director or officer of the corporation; or
>
> (b) as a director or officer of another entity, or in a similar capacity, if the individual acts or acted in that capacity at the corporation's request.

[88] The advantage of a non-profit corporation purchasing directors and officers insurance is that it protects itself from the potential financial responsibility for large claims if its directors and/or officers are sued successfully. Many non-profit corporations lack the resources to cover the cost of a substantial judgment against its

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[84] See for example, Saskatchewan Act, s 111(1) and (4).

[85] Saskatchewan Act, s 111(5).

directors and officers. [86] The disadvantages are that non-profit insurance may be costly to purchase and may contain significant exclusions from coverage. What is your experience with directors and officers liability insurance?

c. Immunity or relief from personal liability

[89] The Saskatchewan Act provides a full immunity for directors and officers.[87] The availability of the immunity is subject to the director or officer acting in good faith and does not apply to fraudulent or criminal misconduct or to criminal or quasi-criminal offences. In contrast, neither the *Societies Act* nor the *Companies Act* provides directors or officers with any limit or relief from personal liability. Similarly, most Canadian non-profit statutes do not contain provisions limiting personal liability for directors or officers. For example, neither the CNCA nor the ONCA contains such a provision.

[90] Nova Scotia's *Volunteer Protection Act* goes even further. Section 3 provides immunity for all volunteers, provided certain conditions are met.[88] The definition of "volunteer" would include directors and officers provided they were not paid in excess of $500 per year, excluding reasonable reimbursement or allowance for expenses actually incurred.

[91] For those jurisdictions that have opted to limit the liability of the directors and officers, the rationale is that, although there are exceptions, the vast majority of board members are motivated by the desire to make a contribution to their community. This commitment translates into an incentive to serve the organization and protect the public.[89]

[92] As an alternative, some have recommended that, rather than a provision granting non-profit directors' or officers' immunity from personal liability, the courts should have the power to provide relief from liability where a director or officer acted honestly and reasonably and ought fairly to be excused.[90] This type of provision is typically found in trustee legislation.[91]

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[86] Saskatchewan Report, at 26.

[87] Saskatchewan Act, s 112.1.

[88] *Volunteer Protection Act*, SNS 2002, c 14.

[89] Saskatchewan Report, at 17.

[90] BCLI Consultation, at 59-60, ALRI Report No. 49, at 53.

[91] See for example, *Trustee Act*, RSA 2000, c T-8, s 41.

d. Dissent

[93] Directors are both individually and jointly and severally liable for the management of a corporation.[92] The inclusion of a dissent procedure protects a board member from being held liable for a decision, where he or she was present at a meeting but dissented on record to a resolution made at that meeting.[93]

[94] Neither the *Societies Act*, nor the *Companies Act* contains any dissent procedure. Some more recent non-profit legislation, however, has included such a provision. For example, s 110 of the Saskatchewan Act provides:

> (1) A director who is present at a meeting of directors or committee of directors is deemed to have consented to any resolution passed or action taken at that meeting unless he or she:
>
> (a) requests that his or her dissent be entered in the minutes of the meeting;
>
> (b) sends a written dissent to the secretary of the meeting before the meeting is adjourned; or
>
> (c) sends a dissent by registered or certified mail or delivers it to the registered office of the corporation immediately after the meeting is adjourned.
>
> (2) A director who votes for or consents to a resolution is not entitled to dissent pursuant to subsection (1).
>
> (3) A director who was not present at a meeting at which a resolution was passed or action taken is deemed to have consented to the resolution unless, within seven days of becoming aware of the resolution, he or she:
>
> (a) causes his or her dissent to be placed with the minutes of the meeting; or
>
> (b) sends dissent by registered or certified mail or delivers it to the registered office of the corporation.

[95] The principal shortcoming of a dissent procedure is that it does not protect a director or officer from liability for decisions that did not come before the board, nor for liability from omissions where the board did not put in place adequate oversight.

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[92] Carter, at 3.

[93] BCLI Consultation, at 63.

F. Member Rights and Remedies

[96] Non-profit corporate legislation should also aim to strike an appropriate balance between the directors' duty to manage the corporation and the members' right to ensure that the corporation stays true to its purpose, and uses its resources to further that purpose. It should also recognize functional differences within the non-profit sector, and enable corporations to tailor their governance structures to meet their needs and circumstances. The current Alberta legislation contains very few provisions concerning member rights and remedies. It is anticipated that the topic will be dealt with, if at all, in the bylaws.

1. MEMBERSHIP

ISSUE 14

Should non-profit corporate legislation include a definition of member? Include any mandatory rules with respect to membership?

[97] Some non-profit organizations are member-focused, and, therefore, structured to enhance member participation, both as patrons and overseers. For example, a professional association or a golf club – where the members' voice or economic interest is central – usually has a governance structure specifically dedicated to a well-defined membership. Many organizations are, however, geared toward public benefit, and use membership as a way to designate program beneficiaries, enrol minor sports players, recruit volunteers, enlist donors, or otherwise affiliate individuals or bodies. For example, a museum or a soccer league – where the members' participation in governance is marginal – generally has a looser membership base which serves, in essence, as an affiliation mechanism.

[98] Non-profit legislation rarely defines what a member is; at best, it sometimes provides that a member is anyone designated by the board of directors. The reason for this omission is probably that there is a degree of arbitrariness to the definition of member. Nonetheless, it is important for a non-profit corporation to define its membership. A non-profit corporation's by-laws may provide for one or more classes of membership, such as ordinary, honorary or youth membership, along with the qualifications for admission to membership, the procedure for admitting members to the corporation, and the membership fees, if any. If the corporation has more than one class of members, the by-laws have to set out the rights, privileges, restrictions, conditions, and period of membership of each class. As a rule, at least one class must

have the right to vote at all meetings of the members.[94] How a corporation defines its membership has a direct impact on the level of rights and responsibilities involved.

2. MEMBER RIGHTS

ISSUE 15

What member rights contribute to ensuring greater effectiveness in carrying out non-profit purposes? What member obligations?

[99] Recent initiatives in non-profit corporate legislation propose to give members the equivalent of shareholders' rights in order to enhance democratic governance. This proposition seems flawed in at least two ways. First, it gives little consideration to the fact that becoming a member is not typically a financial but, rather, a personal commitment to the non-profit corporation. Unlike shareholders, most members have not made a capital investment and, therefore, have no ownership interest in the assets of the corporation to protect.[95] Second, it goes further by equating members with common or ordinary shareholders who are entitled to a share of profit, a share of equity and a share of control as owners of the corporation. But even for non-profit corporations legislation recognizes that conferring the full range of shareholder rights is not always necessary. For example preferred shareholders and bondholders have rights to dividends and/or capital but no voting rights.[96]

[100] It follows that members of a non-profit corporation may not need to have all the rights of ordinary shareholders; however, they need the means to ensure that the corporation adheres to its purpose, or consults them should there be any changes in that purpose. Member rights can be divided into four main categories: access to information; supervision of decision-making; participation in decision-making; and termination of membership. However, the question is who should be entitled to what rights and on what basis. What is your view? Are there rights that should be conferred to particular classes of members? To all members? To other stakeholders?

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[94] Under both the CNCA and ONCA, it is now mandatory to set out the conditions of membership in the articles or by-laws of the corporation, along with the voting rights for each class if there is more than one class of membership. If there is only one class, that class has the right to vote. See CNCA, s 154 and ONCA, s 48. A broader membership base also raises issues related to quorum.

[95] The members of a non-profit corporation typically have no right: to dividends, to a share of equity, or to transfer ownership in the corporation There also seems to be a heighten call for restricting members' right to a share of any remaining assets upon liquidation and dissolution of a public benefit corporation.

[96] Unless provided otherwise, neither preferred shareholders nor bondholders have voting rights, regardless of the importance of the corporate issues being decided.

a. Access to information

[101] The right to access information is often a prerequisite to the exercise of other rights, including the right to monitor the performance of the directors and officers. In general, members have a right to consult, inspect, take extracts or receive certain corporate documents, such as articles of incorporation, by-laws, list of members, financial statements, and public accountant/auditor reports, if any.[97] For instance, the CNCA provides that each member – other than a member who has declined to receive such documentation – is entitled to get a copy of the comparative financial statements before the annual meeting.[98] The corporation is required to give members notice of annual or special meetings, and all relevant documents.[99] Although these rights are important, the details can easily overburden a non-profit corporation if not carefully thought out, especially those corporations with a broad membership base.

b. Supervision of decision-making

[102] The members of a non-profit corporation generally have voting rights that include the right to elect and remove directors and the right to approve key amendments to governing documents. New non-profit legislation, such as the CNCA and ONCA, give members enhanced voting rights, comparable with those of ordinary shareholders under for-profit corporate statutes, if not more generous. Unless otherwise provided in the corporation's articles or by-laws, each member is now entitled to vote. In some cases, non-voting members, both individually and as a class, have the right to vote on matters affecting their membership rights (e.g. the creation of a new class of members or modification to conditions of membership) but also on other fundamental changes (e.g. amalgamation, continuance or extraordinary disposition of the assets of the corporation).[100] Both the CNCA and ONCA provide for various means of voting such as proxies, mailed-in ballots, and electronic voting. Although designed to enhance and facilitate the exercise of the members' voting rights, these requirements should not

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[97] See, for instance, *Societies Act*, ss 30 and 36.

[98] The by-laws may authorize the corporation to give members notice that the statements are available at its registered office. See, for example, CNCA, s 175.

[99] See, for instance, *Societies Act*, s 25. In addition, members who hold a certain percentage of votes have sometimes the right to requisition a meeting for a specific purpose. See, for instance, CNCA, s 167. The by-laws should set out the manner in which notice can be given to members entitled to vote. However, by-laws cannot include provisions that are inconsistent with the governing statute.

[100] These issues are treated in more details in Part H, *Fundamental Changes*.

be imposed lightly as they entail a great deal of logistical support which can quickly strain the resources of any non-profit corporation.[101]

c. Participation in decision-making

[103] Directors and officers are generally in the position with the greatest information, and thus better equipped to manage the corporation. The right to supervise the decision-making process is often enough to ensure that the interests of the members are protected. But there are also ways members can provide direct input, including: unanimous member agreements and member proposals.[102] Increased participation by members may help temper the discretion of the directors and officers. However, members are not responsible for the management of the corporation and may not be able to appreciate the full impact of their interventions.[103] Another option is to encourage non-profit corporations to hold a regular consultation forum to involve the active membership, instead of moving operational issues into the governance area through unanimous member agreements or member proposals.

d. Termination of membership

[104] Members have rights but also obligations; consequently, a corporation should have the power to discipline members or terminate their membership if needed. The directors, members or any committee of directors or members may be granted such power, provided that the articles or by-laws also set out the circumstances and manner in which the power can be exercised.[104] Members should be able to end their membership when they so choose.[105] In general, the rights and privileges of the

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[101] While class voting rights are designed to protect minority shareholders who have a financial interest in a for-profit corporation, their role in the non-profit sector is more questionable.

[102] A unanimous member agreement is a written document which restricts the powers of the directors to manage the affairs of the corporation; the directors are relieved of their duties and liabilities to that extent. Member proposals can be submitted for discussion on any matter related to the corporation at an annual meeting or special meeting; if approved by the membership, the proposal can be either advisory or compulsory (i.e. binding on the directors).

[103] Moreover, members are only one group of stakeholders, particularly in the case of public benefit corporations.

[104] Saskatchewan Act, s 119. Members are entitled to basic procedural rights, including the right to be informed (i.e. notice with reasons) and the right to respond (i.e. fair hearing) if disciplinary action or termination of membership is contemplated. Members who claim to be aggrieved because they were disciplined or had their membership terminated may apply to court for an oppression remedy: see Saskatchewan Act, ss 120-121.

[105] As explained below, members may also have the right to object to important changes in the corporation and to be paid the fair market value of the membership if certain requirements are met.

members are not transferable and cease to exist when: a member is expelled, dies or resigns, a term of membership expires, or the corporation is liquidated and dissolved.[106]

3. REMEDIES

ISSUE 16

What internal remedies are best suited to enforce the rights and obligations of non-profit corporations? What external remedies?

[105] Statutory remedies are the means by which the rights and obligations of members, directors, officers, agents and other employees of a corporation are satisfied or enforced. Member remedies should therefore be connected and limited to those rights and obligations set out in the governing act, articles, by-laws or any unanimous member agreements. A recent trend, however, seems to be to add to member remedies, especially external remedies which typically involves court intervention. In your experience, which type of remedies would be more suitable for the non-profit sector?

a. Internal remedies

[106] Generally speaking, non-profit corporate legislation provides for few internal member remedies. The main remedy is often the dismissal of directors for breach of their duties. Another example, is that members of a membership corporation, such as a golf club or a leisure centre – who have and exercise a right to dissent in respect of certain fundamental changes – may also be entitled to the payment of fair market value for their membership interest, upon which their membership in the corporation will be terminated.[107] Non-profit corporations can also be directed or encouraged to provide for the implementation of dispute resolution processes in their by-laws.

b. External remedies

[107] There are many types of external remedies available to members for enforcing their rights, including derivative actions, oppression remedies, and compliance or

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[106] As previously mentioned, members have sometimes a residual economic interest in the corporation which entitles them to a share of the remaining assets upon liquidation and dissolution. The issue of distribution of assets on liquidation and dissolution is treated in more details in the Part H, *Fundamental Changes*.

[107] See, for instance, Saskatchewan Act, ss 177-179. In both cases, failure to grant such internal remedies usually gives opening to an application to the court to fix a fair value for the membership interest of any dissenting member, or to have the records rectified: see Saskatchewan Act, ss 180-181 and 227.

restraining orders.[108] Other legal actions can also be initiated on application of members, such as court ordered winding-up, investigations, and penalties. However, external remedies are often costly for both the complainant and the corporation, and may not be appropriate in the non-profit context.

G. Financial Accountability and Transparency

[108] Financial accountability and transparency are important components of good governance. Financial accountability refers to an obligation or willingness to explain a corporation's financial situation to stakeholders. Transparency refers to an obligation or willingness to make financial data available. Financial accountability and transparency can buttress the sustainability of an organization by satisfying donors, members and beneficiaries that the corporation is efficiently and effectively pursuing its objects. Different types of non-profit corporations may warrant different levels of financial accountability and transparency, depending on the size of the organization, whether they provide services primarily for the membership or the general public or whether they are publicly or privately funded.

[109] When one thinks of the financial accountability and transparency of non-profit corporations, two broad issues arise: (1) What should be the level of financial review? (2) What should be the required level of financial disclosure? To whom? This Part raises each of these broad issues and considers whether or not they should be included in a clear and enabling legislative framework.

1. LEVEL OF FINANCIAL REVIEW

ISSUE 17

What should be the required level of financial review?

[110] There are essentially three levels of financial review: external audits, review engagements and internal audits. An external audit involves an examination by public accountant of the company's financial records and operations to determine whether the

[108] A derivative action is a legal action brought in the name or behalf of the corporation. An oppression remedy is an action against a corporation which acts in a way that is oppressive or unfairly prejudicial to, or unfairly disregards the interests of a member. A compliance or restraining order is a court order directing a director, officer or employee of a corporation to share information with members, or to comply with – or restrain from acting in breach of – the governing act, articles, bylaws, or any unanimous member agreement. Both the derivative action and the oppression remedy have sometimes exclusion for religious corporations. See, for instance, the CNCA, ss 251-253.

information reported in the financial statements is presented fairly.[109] The public accountant's objective in an audit is to express an opinion on the financial statements. While external audits provide the highest level of assurance to members and the general public, they may not always be necessary given the nature of the accounts or the dollar value involved. Further, the cost and time required to comply may be considerable especially for smaller non-profit corporations.

[111] A review engagement is also conducted by a public accountant. It provides a moderate level of assurance. A review engagement consists primarily of enquiry, analytical procedures and discussion. In a review engagement, the objective is to determine whether the financial statements are plausible in the circumstances.[110]

[112] An internal audit is conducted by board members or members of an organization appointed at the preceding annual general meeting. It is inexpensive, but may not provide the level of assurance of a review by a public accountant.

[113] The *Societies Act* requires an audited financial statement be presented at a society's annual general meeting.[111] It does not specify whether it should be an internal or external audit. In practice, it is very common for society's financial statements to be prepared by way of an internal audit by two persons designated for that purpose. The audited statement must also be submitted to the Registrar as part of the society's annual return.[112]

[114] Under the *Companies Act*, a not for profit company must annually appoint one or more auditors.[113] The requirements are different for private and public companies. A private company may waive the audit requirement by unanimous vote of its members.[114] In contrast, there are no provisions that would allow a public company to waive the audit requirement. In addition, a public company cannot appoint one of its directors, officers or employees as an auditor.[115]

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[109] Chartered Accountants of Canada, *Understanding Financial Statements*, http://www.cica.ca/resources-and-member-benefits/growing-your-firm/client-development-brochure-series/item42782.pdf

[110] Chartered Accountants of Canada.

[111] *Societies Act*, s 25.

[112] *Societies Act*, s 26.

[113] *Companies Act*, s 131(1).

[114] *Companies Act*, s 132.

[115] *Companies Act*, s 132(2).

[115] More recent non-profit statutes provide for a range of financial review. For example, the financial review requirements under the CNCA vary according to the classification of the corporation:[116]

Type of Corporation	Gross Annual Revenues	Financial Review Requirements
Soliciting Corporation	$50,000 or less	Review engagement unless members pass an ordinary resolution to require an audit instead.
	Greater than $50,000 and up to $250,000	External audit unless members pass a special resolution (two-thirds) to undertake a review engagement.
	More than $250,000	Mandatory external audit.
Non-Soliciting Corporation	$1 million or less	Review engagement, but members may pass an ordinary resolution for an external audit instead.
	More than $1 million	Mandatory external audit.

[116] One possibility would be to leave financial review requirements to be determined by the corporation itself. This is essentially the *status quo* under the *Societies Act*. Non-profit organizations can draw from guidelines such as those set up by Imagine Canada in determining the appropriate level of financial review.[117] The advantages of such an approach are that the organization can tailor the level of financial review that best meets the dollar value and complexity of their accounts. Those organizations that rely on external funding will introduce the level of review that would give their funders

[116] For explanatory purposes, this is a simplified summary of the legislation. For the complete detail, see Part 12 of the CNCA.

[117] Imagine Canada, *Standards Program for Canada's Charities and Non-Profits*, April 2012, http://www.imaginecanada.ca/files/www/en/standards/standards_program_handbook_may_2012.pdf, at 6. Imagine Canada provides that organizations with annual review in excess of $1 million have an external audit and that other organizations have a review engagement unless required by their governing legislation to do otherwise.

comfort. The disadvantages are a lack of uniformity and the possibility for less public accountability depending on the method of financial review selected.

[117] Another possibility would be to set out the financial review requirements in the legislation. The advantages of this approach are a greater degree of uniformity and more assurance of accountability. The disadvantages are that the dollar value cut-off or the description of the classification of organization to which the various review requirements should apply may be somewhat arbitrary or artificial. Accordingly, in some cases, organizations may find they are subject to a review requirement that is unnecessary or prohibitively expensive or time-consuming. The inclusion of a waiver provision may provide more flexibility, but it may also weaken the level of accountability. What do you think? In your experience, which approach would work best?

2. FINANCIAL DISCLOSURE

ISSUE 18

What should be the required level of financial disclosure? To whom?

a. Annual financial statements

[118] Annual financial statements are typically prepared in accordance with acceptable accounting standards. The Canadian Accounting Standards Board adopted new financial reporting standards for non-profit organizations that went into effect for fiscal periods beginning on or after January 1, 2012.[118] The new standards are intended to increase transparency and accountability.[119]

[119] Currently, Alberta legislation provides that financial statements shall be made available at the annual general meeting.[120] There appears to be no requirement under

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[118] Chartered Accountants of Canada, *Guide to Accounting Standards for Not-for-Profit Organizations*, September 2012, http://www.cica.ca/focus-on-practice-areas/small-and-medium-practices-(smp)/implementing-the-accounting-standards/item69429.pdf.

[119] Carters, *Charity Law Update*, July/August 2012, http://www.carters.ca/pub/update/charity/12/julaug12.pdf. The new standards distinguish between non-profit corporations that are controlled by the government and those that are not. Under the new standards, private non-profit corporations must choose to follow either Part I of the CICA Handbook (International Financial Reporting Standards) or Part III. It is expected that most non-profit corporations will choose Part III because it is designed specifically for non-profit corporations and is similar to the previous standards.

[120] *Societies Act*, s 25. Section 147(1) of the *Companies Act* provides that financial statements of public companies shall be provided to shareholders 10 days in advance of the annual meeting and s 147(2) provides that shareholders of private companies can demand copies of financial statements.

either Act that statements should be made available either in advance of the general meeting to members or made available to the public.

[120] More recent non-profit corporate legislation goes further and provides that financial statements should be disclosed to members in advance of the annual general meeting.[121] The advantages of providing the statements to members in advance of the annual general meeting are that it would give members more time to review the statements and they would be better prepared to vote on the financial statements. The disadvantages are the costs and resources required to distribute the statements in advance of the meeting.

[121] A related question concerns access to financial statements outside of the annual general meeting by members and the general public. Here the tendency is to distinguish between different classifications of non-profit corporations. For example, s 144 of the Saskatchewan Act, distinguishes between member and charitable corporations. A member organization is required to allow its members access to financial statements at its corporate office during regular business hours. There is no requirement to provide access to the public. A charitable organization, on the other hand, is required, on written notice, to provide access to members of the public to its financial statements. Both access provisions are subject to a court order to the contrary.

[122] Relatedly, in ALRI's Report No. 49 it recommended that where a non-profit corporation had received public monies then the annual financial statements should be filed with the Registrar. The general public would then be able to access the financial statements via that office.[122] The CNCA also requires that annual financial statements be filed with Corporations Canada, although it's not clear whether the general public could then access these statements.[123]

[123] Another question concerns whether the legislation should also provide for the possibility of exempting the disclosure of certain information from the financial statements where it would be detrimental to the corporation. For example, s 143 of the Saskatchewan Act provides that a corporation can apply to the Director of Corporations for an order exempting the disclosure of certain information.

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[121] For example, s 146 of the Saskatchewan Act requires that financial statements be sent to members 15 days in advance of the annual general meeting.

[122] ALRI Report No. 49, at 19.

[123] CNCA, s 176.

b. Other financial information

[124] Apart from the disclosure of financial statements, discussed in the preceding section, the issue arises whether the legislation should include any other minimum financial disclosure requirements. For example, should members, donors or the public be able to access financial information concerning the operations of a non-profit corporation, the cost of a contract, or the cost-effectiveness of fund-raising activities?[124]

[125] To date, no other Canadian jurisdiction has included such a provision. Would the inclusion of such a provision create a corresponding duty on the part of directors and officers to use funds most effectively? Is this desirable? Is this a matter best dealt with through best practices? We would be interested in learning about the experience of non-profit corporations in this regard.

H. Fundamental Changes

ISSUE 19

What provisions concerning fundamental changes do you think should be included in any reformed non-profit corporate legislation?

[126] Fundamental changes include:

a. amalgamation with another corporation;

b. continuance of the corporation into another jurisdiction;

c. the sale of or disposition of substantially all of the corporation's assets; and

d. a proposal to dissolve, or to liquidate and dissolve, the corporation.

[127] Common to all of these topics is the recognition that there are gaps in the current Alberta legislation. These gaps have the potential to affect the governance of the organization, member rights or fail to reflect key characteristics of the non-profit sector. Each of these individual topics is discussed below. In addition, this Part will also address an issue concerning the registration of extra-provincial non-profit corporations.

[124] See also the discussion in Part F, *Member Rights and Remedies*.

a. Amalgamation with another corporation

[128] Amalgamation is not common in the non-profit sector, but there may be instances where two non-profit corporations do chose to amalgamate.[125]. There are significant differences between the amalgamation procedure under the *Societies Act* and that of the *Companies Act*.[126] They further differ with the amalgamation procedures under the BCA. Procedural differences aside, the effect of amalgamation is the same under all three statutes – the amalgamating corporations continue as one amalgamated company as of the date and time the amalgamation application is approved.

[129] Most recent non-profit corporate statutes have adopted amalgamation provisions that are closely harmonized with their for-profit corporate statute counterparts. The issue here is largely procedural: What amalgamation procedures should be included in any revised non-profit corporate statute in Alberta?

b. Continuance in another jurisdiction

[130] Currently, neither the *Societies Act* nor the *Companies Act* permits the continuation of an extra-provincial non-profit corporation. The reasons an extra-provincial non-profit corporation might want to continue under Alberta's non-profit legislation include the following: (1) the majority of an extra-provincial non-profit corporation's members have moved to Alberta; (2) to facilitate an amalgamation; (3) to take advantage of the availability of a preferred corporate name; or (4) to take advantage of legislative variations.[127]

[131] Many corporate statutes both in the non-profit and for-profit sector include continuation provisions.[128] These provisions save corporations time and money if they wish to continue in another jurisdiction. The alternative is a complex, time-consuming and costly series of steps. Should Alberta's non-profit corporate legislation provide for the continuance of an extra-provincial non-profit corporation as an Alberta non-profit corporation?

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[125] For example, two existing non-profit organizations that offer similar services in different parts of the province, may chose to amalgamate to form a single organization with greater province-wide reach.

[126] For example, the *Societies Act* provision (s 32) is far less detailed than the *Companies Act* (s 172). The *Societies Act* also requires an amalgamation agreement whereas this is optional under the *Companies Act*. Under the *Societies Act*, amalgamation is approved by the Registrar, whereas under the *Companies Act* this is a court approved process.

[127] BCLI Report, at 125.

[128] See for example, BCA, s 188, Saskatchewan Act, ss 174-175 and CNCA, ss 209-211.

c. The sale of or disposition of substantially all of a corporation's assets

[132] The *Societies Act* is silent regarding the sale, lease, exchange or disposal of substantially all the corporation's assets. Section 20(1)(l) of the *Companies Act* gives the corporation the power to "dispose of the undertaking of the corporation." There is no requirement of member approval. The *Companies Act* approach appears to be consistent with the common law where directors have the complete power to dispose of the corporate undertaking without consulting the members. [129]

[133] In contrast, most modern for-profit and non-profit statutes have modified the common law rule, as leaving this type of decision to directors alone leaves open the potential for misconduct.[130] The approach taken is essentially that where a sale, lease or exchange of all or substantially all the property of a corporation occurs (other than in the ordinary course of business of the corporation) it must be authorized by a special resolution of the members. Should members of Alberta non-profit corporations have a say in whether or not a corporation disposes substantially all of its assets?

d. A proposal to dissolve, or to liquidate and dissolve, the corporation

[134] There are procedural differences concerning the dissolution, liquidation and restoration of non-profit corporations between the *Societies Act* and the *Companies Act*.[131] Both current acts are silent, however, regarding what happens to surplus assets upon dissolution. Given the importance of the non-distribution constraint to the non-profit identity, the question of what should happen this surplus is a key issue to be considered.

[135] There are essentially two different legislative approaches regarding the disposal of assets upon dissolution. First, those that are prescriptive and try to mirror the requirements of the *Income Tax Act* and second, those that leave the matter to the individual corporations to determine. The CNCA provides an example of the former approach. A corporation that is a registered charity or a soliciting corporation is required to distribute its property to another "qualified donee" as defined by subsection 248(1) of the *Income Tax Act*.[132] The rationale for this approach is to bring the corporate

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[129] *Daniel v Gold Hill Mining Co.*, as referred to on p. 123 of the BCLI Report.

[130] See for example, BCA, s 190, the Saskatchewan Act, s 176(3) and the CNCA, s 214.

[131] Section 35 of the *Societies Act* imports by reference the procedures under part 17 of the BCA with only some minor adjustments; whereas, Part 10 of the *Companies Act* contains its own detailed provisions concerning liquidation and dissolution.

[132] CNCA, s 235.

legislation in line with the requirements of the *Income Tax Act*. A corporation that is not a registered charity or a soliciting corporation is to distribute its property based on the statement in the articles for distribution of assets on dissolution.[133] If the articles do not provide for the distribution of assets on dissolution, then the remaining property is to be divided "into as many equal shares as there are memberships in the corporation and distributed at the rate of one share to the holder of each membership."[134]

[136] In contrast, rather than a specific legislative provision concerning the disposal of assets upon dissolution, ALRI Report No. 49 proposed to leave the question to the individual corporation. It recommended the legislation include default provisions where a corporation's articles are silent on the issue. No formal rationale was provided for this approach, however, it appears to be in line with a stated desire for flexibility – such that it leaves "incorporated associations free to enter into such restrictions upon its activities as are necessary to conform to the *Income Tax Act*."[135]

e. Registration of extra-provincial non-profit corporations

ISSUE 20

Would it be useful to include the registration provisions for extra-provincial non-profit corporations in the non-profit corporate legislation, rather than in the BCA?

[137] Section 279 of the BCA requires a corporation, including a non-profit corporation, that is incorporated in another jurisdiction, but "carrying on business" in Alberta, to register in Alberta.[136] ALRI's Report No. 49 explained the process and the purpose of registration as follows:

> Registration involves providing the Registrar with the corporation's fundamental corporate information, and it also involves the appointment of an attorney in the province for service of documents upon the corporation. The purpose of registration is to give Albertans a place in the province where they can obtain basic information about a corporation and a place in the province where they can serve it with notices and legal process.

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[133] CNCA, s 236.

[134] CNCA, s 236. There are some variations on this approach. See for example, BCLI Consultation, at 20.

[135] ALRI Report No. 49, at 22.

[136] Section 277(1) of the BCA defines "carrying on business" broadly so as to include a corporation if (a) it name is listed in a telephone directory in Alberta, (b) its name is in an advertisement with an Alberta address as a place of contact, or (c) it has a resident agent, warehouse or office or place of business in Alberta.

[138] Although the registration requirement applies to both for-profit and non-profit corporations, it is only found in the for-profit legislation (the BCA). It is perhaps, therefore, not surprising that the number of non-profit corporations registering extra-provincially in Alberta is quite low. There are two possible explanations: 1) non-profit corporations may not be aware of the requirement to register extra-provincially as it is only in found under the BCA, or 2) some corporations might extra-provincially register without identifying as non-profits. The latter explanation is unlikely, however, as the filing fee for registering extra-provincially as a non-profit is lower than that of a for-profit. The question is, therefore, whether any extra-provincial registration requirement for non-profit corporations should be included in the applicable non-profit corporate statute?

I. Transitional Issues

ISSUE 21

What would you see as a workable transitional arrangement for any new non-profit corporate legislation?

[139] Transitional arrangements are important to the successful implementation of any new non-profit corporate legislation. A number of sub-issues related to any transitional arrangement are discussed below:

1. How should reformed non-profit corporate legislation apply to existing societies and Part 9 companies?
2. What transitional period would be appropriate?
3. What resources should be made available?

1. EXISTING SOCIETIES AND PART 9 COMPANIES

[140] The first sub-issue concerns how any new non-profit corporate legislation should apply to existing societies incorporated under the *Societies Act* and to companies incorporated under Part 9 of the *Companies Act*. Should it be mandatory for existing societies and companies to re-register under the new legislation or should this be optional? The primary reason for a mandatory approach is that existing corporations will get the benefit of the reformed provisions. If a mandatory approach is adopted, what should be the consequences of failing to re-register? Dissolution, deemed conformity or other?

[141] Canadian jurisdictions that have recently reformed their non-profit corporate legislation have adopted a mandatory approach; however, the consequences of failing to register differ greatly depending on the legislation. The CNCA gives existing corporations a three-year period within which to apply for a certificate of continuance.[137] In order to apply for a certificate of continuance, a corporation must replace its letters patent, supplementary letters patent (if any) and by-laws. The articles and by-laws must comply with the CNCA. The legislation provides that if an existing corporation is not continued under the CNCA before the three year deadline, it may be dissolved by Corporations Canada. A dissolved corporation would, however, be able to apply for revival under the CNCA.

[142] In contrast, the consequences under the ONCA for failing to continue under the new Act are deemed conformity. An existing non-profit corporation that does not amend its Letters Patent, Supplementary Letters Patent, by-laws and any special resolutions into conformity with the Act, will be deemed to have been amended to bring them in conformity with the ONCA.[138]

2. TRANSITIONAL PERIOD

[143] Typically, where existing non-profit corporations are required to continue under new legislation a transitional period is provided to allow these organizations time to understand and to comply with the requirements of the new act. What period of time would be an appropriate transitional period?

[144] As described, both the CNCA and ONCA adopt a three year transitional period. Is this sufficient time? The same transitional period was also used in Alberta for for-profit companies registered under the *Companies Act* who were required to continue under the BCA.[139]

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[137] CNCA s 297(5) and (6).

[138] ONCA, s 207. There is some concern that confusion could arise from inconsistencies between the corporation's Letters Patent and by-laws, documents the directors, members and staff are most likely to go to for guidance or work with, and the deemed amendments required by the Act. See for example, Kate Lazier, *Transition Under the Ontario Not-for-Profit Corporations Act, 2010*, Miller-Thomson, Charities and Not-for-Profit Newsletter, April 2010, available online at: http://www.millerthomson.com/en/publications/newsletters/charities-and-not-for-profit-newsletter/2012_archives/april-2012/transition-under-the-ontario-not-for-profit

[139] The BCLI Report at 21 adopts a 2 year transitional period (the same period of time that was used in B.C. to transition for-profit corporations from the *Companies Act* to the *Business Corporations Act*.) BCLI recommends that within the two-year transitional period, a pre-existing society must file the transition application (which includes a constitution) and alter its bylaws to the extent required.

[145] A further question is whether the transitional period should be the same for all provisions of the non-profit corporate legislation or for all classifications of non-profit corporations? For example, an earlier draft of the ONCA provided that those non-profit corporations that were "predominately social in nature" would have five years to bring themselves in compliance with the new Act. Is this type of differentiation desirable?

3. RESOURCES

[146] If the decision is made that existing societies and Part 9 companies should be continued under the new legislation, then an important sub-issue is how to minimize the costs and what resources should be made available to them during the transitional period?

[147] Under both the ONCA and the CNCA, transitional materials recommend that existing non-profit corporations obtain legal advice to review their constitutive documents to ensure they are consistent with the new legislation. This can be a costly endeavour for smaller non-profit corporations. If new non-profit corporate legislation was introduced, are there existing organizations that could assist and advise non-profit corporations in revising these documents?

[148] Would the availability of standard form bylaws be of assistance in this regard? In Ontario, for example, the Ministry of Consumer Services intends to prepare a set of standard form by-laws for not-for-profit corporations governed by the ONCA. Where a corporation fails to pass organizational by-laws within 60 days after it is incorporated, section 18(1) of the ONCA deems that the standard organizational by-laws will apply. Those standard organizational by-laws will be published in the Ontario Gazette and made publicly available.

[149] What other resources should be made available to non-profit corporations to assist with the transitional process? A related question concerns whether any additional resources are required by the Registry Office to accommodate the number of organizations applying to continue under the new legislation?

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